

Ofwat  
Centre City Tower  
7 Hill Street  
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31st January 2020

By email  
For the attention of: Rachel Fletcher, Chief Executive

Dear Rachel

I am pleased to inform you that following careful consideration of the Final Determination for Dŵr Cymru published on 16 December, the Board has decided not to ask Ofwat to refer the determination to the Competition and Markets Authority.

This conclusion is due in large part to the constructive and focused engagement between Ofwat and my colleagues since the Draft Determination, and the detailed consideration of the issues set out in our 30 August representations. Please pass on our thanks to David Black and his team for the thorough and timely review of our final submission and the constructive engagement thereafter.

I must reiterate however that, whilst we believe the outcome of the process represents good value for customers over the next five years, the Final Determination represents an extremely challenging settlement for the business. As we have said throughout the process, we remain of the view that, however much we stretch the business, some of the performance targets are not achievable, given our company's operating environment and the available level of investment. We do not, therefore, agree with Ofwat's position that failure to achieve a target could in itself constitute a breach of licence conditions warranting possible enforcement action.

As we move into AMP7, we believe Ofwat needs to develop specific 'efficient' performance targets for different companies using a modelling approach, as it does for cost assessment. This would require early engagement with companies to gather data to populate such models for PR24. Performance targets should, in our view, take into account the variation in customer 'benefits' (as demonstrated by company-specific customer research) and the differing costs of delivering improvements across companies. For key measures this would produce targets that lead to more efficient use of customers' resources as well as fairer, and more effective, delivery incentives.

As we have consistently argued through the PR19 process in our public submissions, while the consistency of definitions across the industry has improved, we understand that companies still report some underlying data in different ways. Given the increased prominence of ODIs, with very substantial

financial penalties and rewards, and the potential impact on customer trust and the reputation of the industry, it is essential that Ofwat prioritises independent, horizontal audits as part of its AMP7 programme, to ensure companies are calculating and reporting common measures on a consistent basis.

We have particular concerns regarding Retail. As a consequence of the FD, our household retail business will be loss-making throughout AMP7. We note that Ofwat's cost assessment models for Retail were objectively less robust than the wholesale models, which in our case results in an efficiency target which we have consistently said is unachievable. There remains material scope to improve retail cost models by taking account of wider factors such as standards of service, and by improving underlying data. We suspect that differences in accounting methods in relation to bad debt and revenue recognition also skew the models and undermine their validity. Again, independent, horizontal audits of companies' data are essential for robust data and the development of improved models for PR24.

Finally, our Business Plan was firmly set in the context of our long-term strategy - Welsh Water 2050 - and our ownership model makes us uniquely positioned to look this far ahead. The importance of taking a long-term approach to setting investment priorities and finding ways of working with nature to deliver the sustainable management of natural resources, are key policy priorities for the Welsh Government and, therefore, of ourselves. As noted by both the UK National Infrastructure Commission and the National Infrastructure Commission for Wales, the rising challenges caused by climate change require a long-term approach to ensuring our networks, towns and cities are resilient. In view of this, we believe all parties involved in determining the strategy for water and wastewater services in Wales, including Ofwat, should take a fully collaborative approach, and begin working together earlier to define the priorities for AMPs 8 and 9 ahead of PR24. The objective would be to reach a common understanding of the optimal investment programme for customers and the environment, given that long-term perspective, in advance of Ofwat commencing its PR24 exercise.

In anticipation of the upcoming lessons-learned exercise for PR19, we look forward to providing more detailed points in due course. We would also hope to be able to make a meaningful and timely contribution to the design of the next price review.

Kind regards



**Chris Jones**  
**Chief Executive Officer**



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